

Internal Revenue Service

memorandum

TL-N-701-88

CC:TL:TS/PHECK

date: 1988

JAN 24 1988

to: District Counsel, Seattle W:SEA

from: Acting Director, Tax Litigation Division CC:TL

subject: TEFRA Partnerships - Effect of Form 870-P
[REDACTED]

This memorandum is in response to your request of October 22, 1987, for technical advice concerning the defense of the above-referenced case pending in Tax Court.

ISSUES

1. What effect does the signing of the Form 870-P (Settlement Agreement for Partnership Adjustments (Under I.R.C. § 6224)) by a taxpayer-husband have on a joint petition filed with the Tax Court contesting the assertion of negligence and overvaluation penalties that are based on the TEFRA partnership losses claimed by the taxpayer-husband and taxpayer-wife on their joint Form 1040 for [REDACTED].

2. What is the effect of taxpayer-wife's failure to sign the Form 870-P.

3. What is the effect of the taxpayers' request for an overpayment of the income taxes paid with respect to the TEFRA partnership adjustments.

CONCLUSIONS

1. The Form 870-P executed by the husband and accepted by the Service is a binding and enforceable contract as to the husband that may not be rescinded absent fraud, malfeasance, or misrepresentation of fact. The absence of the taxpayer-wife's signature on the Form 870-P should have no affect on the joint petition filed by the petitioners contesting the assertion of the additions to tax based on the TEFRA partnership losses. Both petitioners will have an opportunity to litigate the applicability of the additions to tax and additional interest before the Tax Court.

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2. Although the document specifically requires the signature of both spouses in a joint return context, the absence of one signature does not invalidate the agreement but merely prevents the assessment and collection as to the non-signatory of any deficiency with respect to the partnership adjustments agreed to by the husband.

3. The determination of partnership items of the [REDACTED] for the taxable year [REDACTED] is properly reflected in the binding settlement agreement, Form 870-P, executed by the taxpayer-husband. Consequently, petitioners are not entitled to an overpayment.

FACTS

This case involves the joint income tax return for the taxable year [REDACTED] filed by [REDACTED] and [REDACTED] on [REDACTED]. In 1982, taxpayer-husband was an investor in [REDACTED], a TEFRA limited partnership. The partnership was audited and on [REDACTED], the Service issued a notice of Final Partnership Administrative Adjustment (FPAA) accompanied by a Form 870-P (Settlement Agreement for Partnership Adjustments (Under I.R.C. § 6224)). On [REDACTED], taxpayer-husband executed the Form 870-P with respect to the [REDACTED] adjustments. This Form 870-P was accepted on behalf of the Commissioner on [REDACTED] by the Chief, TEFRA Technical Support at the Fresno Service Center.

On [REDACTED], the Service issued a statutory notice of deficiency to taxpayer-husband and taxpayer-wife for an income tax deficiency and penalties owed for the taxable year [REDACTED]. A review of the notice discloses that parts of the negligence penalty under I.R.C. § 6653(a)(1) and (2), the valuation overstatement penalty under section 6659, and the additional interest penalty under 6621(c) were based on the taxpayers' involvement with the [REDACTED].

The tax matters partner of [REDACTED], [REDACTED], filed a petition on [REDACTED], with respect to the FPAA issued for the [REDACTED] taxable year. Also, it appears that taxpayer-husband paid the income taxes owed on account of the adjustments made to the [REDACTED].

DISCUSSION

In recent months the Tax Litigation Division has received numerous inquiries concerning Form 870-P (Settlement Agreement for Partnership Adjustments). Many taxpayers have argued that the so-called "settlement agreement" does not propose the settlement position of the Service but provides for the total concession by the taxpayer of all of the adjustments proposed by the Examination Division. Many taxpayers have argued that they have been misled into mistakenly conceding their cases.

The questions repeatedly being raised by taxpayers is one of fairness and whether the Service is taking advantage of taxpayers by labelling the Form 870-P a "settlement agreement" when the result of such agreement is full concession by the taxpayer to the Service's proposed adjustments. The instant case is another example of the confusion surrounding the Form 870-P.

In response to the taxpayers' concerns that they are being misled, the Service is taking steps to modify Form 870-P and the correspondence accompanying the agreement (i.e. the "60-day letter") to ensure that taxpayers fully understand the ramifications of executing the settlement document. It is expected that these revisions will eliminate much of the confusion surrounding the Form 870-P.

With regard to the [REDACTED] case, the Form 870-P executed by the taxpayer-husband on [REDACTED], and accepted by the Service on [REDACTED], is a binding contract as to the husband that may not be rescinded absent fraud, malfeasance, or misrepresentation of fact. Although the document specifically requires the signatures of both spouses in a joint return context, the absence of one signature does not invalidate the agreement but merely prevents the assessment and collection of any deficiency with respect to the partnership adjustments as to the non-signatory. In other words, if the husband executed the Form 870-P and paid the tax assessed with regard to the computational adjustment, both the agreement and assessment are valid despite the absence of the wife's signature on the Form 870-P.

It should be noted that in terms of Service personnel following established procedures, the [REDACTED] case is apparently an aberration. Examination personnel are instructed not to accept settlement agreements (e.g. Form 870, Form 870-P) without first ascertaining the taxpayer's filing status. In this case, the Service Center should have learned of the [REDACTED] filing status by either associating the taxpayers' return with the Form 870-P or checking PCS (Partnership Control System). Examination has been made aware of this case and has advised us that it will re-instruct its field offices on the proper procedures to follow when processing Form 870-Ps.

As indicated above, the taxpayer-wife's failure to sign the settlement agreement does not affect the validity of the document as it relates to taxpayer-husband. If it is verified that the taxpayer-husband made a payment on the account, however, assurances should be obtained that the assessment was made in the husband's name only. To avoid challenges to the validity of the Form 870-P and to minimize potential litigation hazards, the wife should not be assessed for amounts relating to the partnership adjustments as set forth in the settlement agreement.

While our position with respect to the husband is clear, the failure of the wife to sign the settlement agreement poses a perplexing question. Specifically, does the taxpayer-wife retain the right to participate in the judicial partnership proceeding under TEFRA? In other words, what affect, if any did the taxpayer-husband's execution of a settlement agreement have on the taxpayer-wife's ability to contest the partnership adjustments?

Under Treas. Reg. § 301.6231(a)(2)-1(a), a spouse who files a joint return with an individual holding a separate interest in the partnership shall be treated as a partner for purposes of Subchapter C of chapter 63 of the Code. Thus, a spouse who files a joint return with a partner will be permitted to participate in administrative and judicial proceedings. There is no dispute that the taxpayer-wife in the instant case could have participated in the administrative and judicial proceedings with her husband had he not signed the settlement agreement. Whether she retains rights under TEFRA independent of her husband is another matter.

Once the taxpayer-husband executed the settlement agreement, his partnership items became nonpartnership items and he was removed from the TEFRA proceedings. The statute and the regulations do not specifically address the question of whether the taxpayer-wife remains a partner covered by the TEFRA provisions. Section 6231(b)(1) provides that a husband and wife who have a joint interest in a partnership shall be treated as 1 person. Treas. Reg. § 301.6231(a)(2)-1(a)(3) provides generally that a spouse who files a joint return with an individual holding an separate interest in the partnership shall be treated as receiving any notice received by the individual holding the separate interest. In essence, TEFRA appears to treat a married couple as one unit with each spouse assuming certain obligations on behalf of the other. Consequently, an argument can be made in the instant case that the husband's actions with respect to his partnership interest in [REDACTED] effectively removed the wife from the TEFRA proceedings.

Further, the absence of the wife's signature on the Form 870-P should have no affect on the joint petition filed by the taxpayers. While the wife could challenge an assessment made against her with respect to the partnership adjustments, the joint petition commenced a separate action. As such, both petitioners will have an opportunity to contest the asserted penalties.

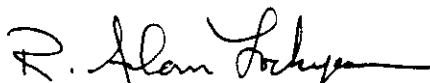
It is also worth mentioning that section 6224(c) provides, in part, that an indirect partner is bound by any settlement agreement entered into by the pass-thru partner. Although the question remains whether the husband can be classified as a pass-thru partner and the wife as an indirect partner, this is an argument that has some potential and could be used should the wife seek to participate in the TEFRA proceeding or challenge the pending deficiency proceeding.

As a final comment, the statutory notice of deficiency issued jointly to the husband and wife is a timely notice which was timely petitioned and answered. In the petition, however, petitioners raise a serious matter concerning the disposition of [REDACTED]. Petitioners claim this partnership is covered by the TEFRA provisions. An inquiry should be made by district counsel to determine the validity of these allegations. If [REDACTED] is covered by TEFRA, then a motion to dismiss for lack of jurisdiction and to strike from the pleadings any reference to [REDACTED] would be in order.

In summary, the settlement agreement executed by the taxpayer-husband and accepted by the Service is a binding and legally enforceable document as to the husband. The computational adjustment and assessment (if in fact made) properly reflects the treatment of [REDACTED] partnership items as determined in the Form 870-P. Consequently, petitioners are not entitled to an overpayment. To avoid potential litigation hazards, it is recommended that the assessment be made in the taxpayer-husband's name only since the wife did not sign the settlement agreement.

Any questions regarding this matter should be directed to Patrick G. Heck at FTS 566-4174.

PATRICK J. DOWLING



R. ALAN LOCKYEAR
Senior Technician Reviewer
Tax Shelter Branch